

CMP: Rs.205

Recommendation: BUY

Target Price: Rs.257

Sector: Alcohol & Tobacco**Key Data**

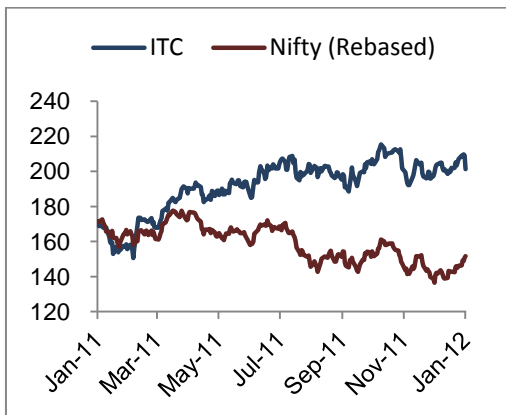
Financial Year End	March
Market Cap (Rs. Cr.)	159,075
Market Cap (USD Bn.)	31.8
52 Week H/L	216/149
Avg. 12M volumes ('000)	7,949
Face Value (Rs.)	1
Bloomberg	ITC IN
Reuters	ITC.BO
NSE	ITC
BSE	500875

Source: BSE, SIHL Research

Shareholding Pattern

	Q3 FY12	Q2 FY12
Promoters	0.0%	0.0%
FII's	16.3%	15.3%
DII's	34.8%	35.2%
Others	48.9%	49.5%

Source: BSE, SIHL Research



Source: Ace Equity, SIHL Research

Low cigarette volume negated by price hike; revenue up 16.6% YoY

ITC cigarette business continued its stellar performance in Q3 FY12, recording a revenue growth of 16.6% YoY and 8.9% QoQ to Rs.3,233 Cr. Growth in cigarette volumes was higher merely by 5% YoY (~8% YoY growth in H1 FY12) due to higher base in Q3 FY11 (2.5% volume growth in Q3 FY11; highest quarter growth in FY11, due to inventory pile up before the implementation of new graphical warnings on cigarette packs in December 2010). EBIT for cigarette segment grew by 20.3% YoY to Rs.1,844 Cr. due to price hike of around 4%; Gold Flake Kings (by 10%), Scissors (by 11%) and Benson & hedges (by 4%). ITC is creating buffer for a potential excise hike in recent months. We estimate a 15% excise hike in tobacco in FY13. Cigarette volumes are likely to decline, even if such excise hike was implemented, due to addictive nature of cigarettes. We estimate a price hike around 14-15% in wake of excise duty hike of around 15% and volume growth of 1%. Due to above sensitivity, we estimate cigarette revenue CAGR growth 17.7% in FY11-13. The uplift in volume growth is likely to be driven by faster growth in less price sensitive king size brands (account for 15% of ITC volume) and premium RSFT brands (account for 29% of ITC volume) due to consumer preference on premium brands and price gap narrowing between premium RSFT and popular RSFT.

Strong performance from FMCG (non-cigarette) division; EBIT losses decline by 36.6% YoY

ITC's FMCG (non-cigarette) business sales in Q3 FY12 grew by 24.4% YoY and 2.2% QoQ to Rs.1,371 Cr. ITC's continue to show focus on recording lower losses at Rs.47 Cr. vs. Rs.74 Cr. YoY and Rs.56 Cr. QoQ. EBIT margin increased by 328 bps YoY and 77 bps QoQ led by higher growth in packaged food and stationary segment. Packaged foods sales posted strong volume growth and profitability is picking up. Growth was led by biscuits (Sunfeast launching new variants at the premium end), atta (Aashirwad growing in volumes and realizations) and Bingo. We believe the premiumization strategy in biscuits is driving margins for ITC's food products. Growth in personal care segment remains strong with new launches in soaps, shampoos and increased distribution led growth in skin care. Lifestyle retail posted healthy growth; however slackening consumer demand is visible. We estimate FMCG (non-cigarette) business to break even in mid FY13.

Subdued performance from agri-business

Agri business reported a revenue growth of 6.8% YoY but decline of 20.6% QoQ to Rs.1,139 Cr. EBIT margin decline by 79 bps YoY and 421 bps QoQ to 12.4%. Growth in agri division was led by higher volumes and increase in realization of leaf tobacco and wheat. ITC has commenced its trial production for leaf threshing facility in Mysore. We estimate this unit to accelerate sales and improve margins going forward. According to management, the division has not witnessed any material benefits from USD appreciation during the quarter and the growth in sales has been primarily led by volumes.

Hotel business EBIT margin improve; aided by cost saving

Hotel business revenues increased 32% QoQ but declined 1% YoY to Rs.279 Cr. Lower sales was on account of lower foreign tourist travel from Europe and USA due to weak global economic situation and additional supply of hotel properties in key markets is further putting pressure on ARR's (Average Room Rate). Despite difficult times, ITC continue to invest in build up hotels. It is in process of launching its new super luxury properties at Chennai, Kolkata and at Classic Golf Resort near Gurgaon, while it is also in the process of investing in land for a luxury hotel property in Colombo, Sri Lanka. The Sri Lanka venture will be a first out of India property investment by ITC Hotels. Key improvement in EBIT margin was due to saving in power and fuel expenses where the company switched to wind mills in the current year as compared to grid power in the previous corresponding period.

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Higher sales of value added products improve paper division margin

Revenue from Paper division grew by 11.5% YoY but decline 2.7% QoQ to Rs.978 Cr. EBIT margin in Q3 FY12 improve by 111 bps YoY to 22.9%. The improvement in profitability during the quarter was due to the improvement in mix as against a low base of the previous corresponding period when the profitability of the division was impacted by uncertainty over graphical warnings, impacting its packaged paper sales. During the previous corresponding period (3QFY12), ITC's paper division had witnessed lackluster growth in sales of 8% and a 5% decline in EBIT due to the uncertainty over graphical warnings in cigarettes which had led to the shutdown of production in ITC's cigarette unit for about 10 days.

During 3QFY12, due to normalization of operations, higher margin packaged paper grew at a higher rate over the previous corresponding period which in turn led to a richer mix and better profitability for the division.

Valuation & Outlook

Cigarette business revenue grew by 16.6% YoY but volume growth was only 5% YoY due to high base in Q3 FY11. Revenue growth in cigarette segment was mainly aided by price hike of around 4%. We estimate concerns over excise duty is overplayed as ITC's cigarette volume CAGR is around 2% over FY00-11, however revenue CAGR is around 10.6% over the same period. We estimate this trend is likely to continue. We estimate a price hike around 14-15% in wake of excise duty hike of around 15% and volume growth of 1%. We have revised our FY12 and FY13 revenue to Rs.25,435 Cr. and Rs.29,307 Cr. respectively (earlier Rs.25,819 Cr. in FY12 and Rs.29,547 Cr. in FY13). We have also revised our EBITDA margin for FY12 and FY13 to 36% and 35.5% respectively as we do not foresee major change in EBIT margin for cigarette segment despite excise hike of around 15%. FMCG (non-cigarette) segment losses continue to fall and brands achieving break-even at faster pace, we believe this business would consequently become profitable by FY13. With commencement of leaf threshing facility in Mysore, we estimate volume growth and improvement in EBIT margin for agri business segment.

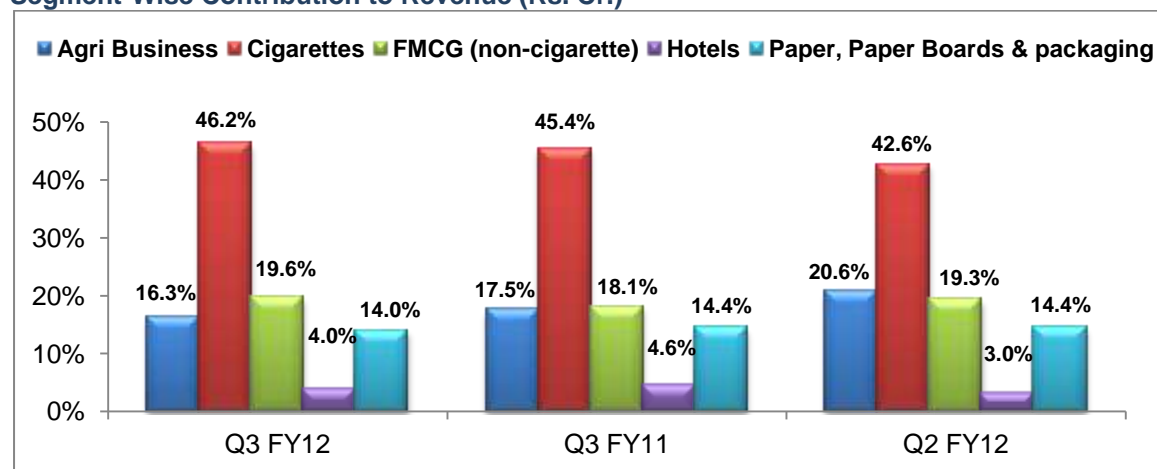
We have valued the stock on weighted average of stock price arrived based on two different valuation parameters. On EV/EBITDA we arrived at a value of Rs.255/share @ 50% weight. On a PE basis we arrived at a value of Rs.260/share @ 50% weight; based on the weighted average, target price for ITC stock comes at Rs.254/share.

We upgrade our target price to Rs.257 (earlier Rs.254) and reiterate BUY, with investment horizon of 12 month and upside potential 25.4%.

Exhibit 1: Segment-Wise Contribution to Revenue (Rs. Cr.)

Revenue from Operations	Q3 FY12	Q3 FY11	YoY	Q2 FY12	QoQ
Agri Business	1,139	1,067	6.8%	1,435	-20.6%
Cigarettes	3,233	2,773	16.6%	2,968	8.9%
FMCG (non-cigarette)	1,371	1,102	24.4%	1,341	2.2%
Hotels	279	282	-1.0%	211	32.0%
Paper, Paper Boards & packaging	978	877	11.5%	1,005	-2.7%
Total	7,000	6,100	14.7%	6,960	0.6%

Source: Ace Equity, SIHL Research

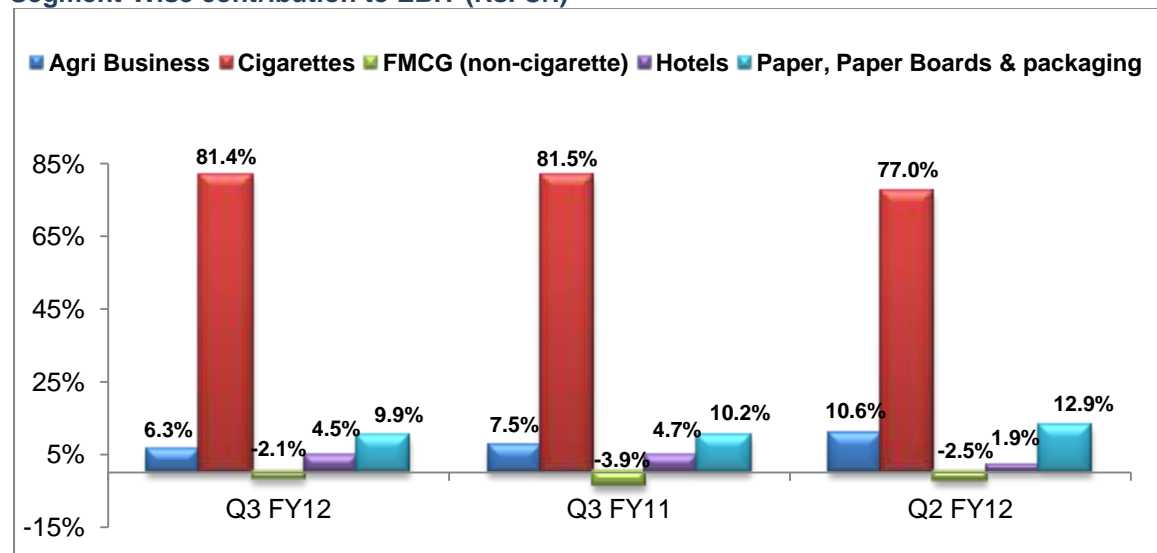
Segment-Wise Contribution to Revenue (Rs. Cr.)

Source: Ace Equity, SIHL Research

Exhibit 2: Segment-Wise contribution to EBIT (Rs. Cr.)

Segment Results	Q3 FY12	Q3 FY11	YoY	Q2 FY12	QoQ
Agri Business	142	141	0.4%	239	-40.7%
Cigarettes	1,844	1,533	20.3%	1,729	6.7%
FMCG (non-cigarette)	(47)	(74)	-36.6%	(56)	-16.6%
Hotels	102	89	14.8%	43	134.2%
Paper, Paper Boards & packaging	224	191	17.2%	290	-22.6%
Total	2,265	1,880	20.5%	2,245	0.9%

Source: Ace Equity, SIHL Research

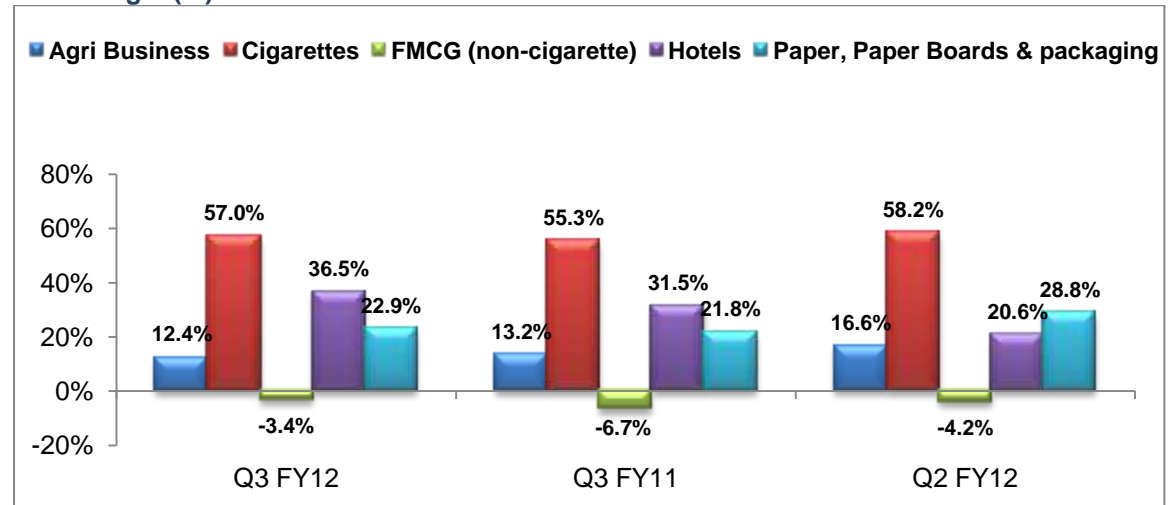
Segment-Wise contribution to EBIT (Rs. Cr.)

Source: Ace Equity, SIHL Research

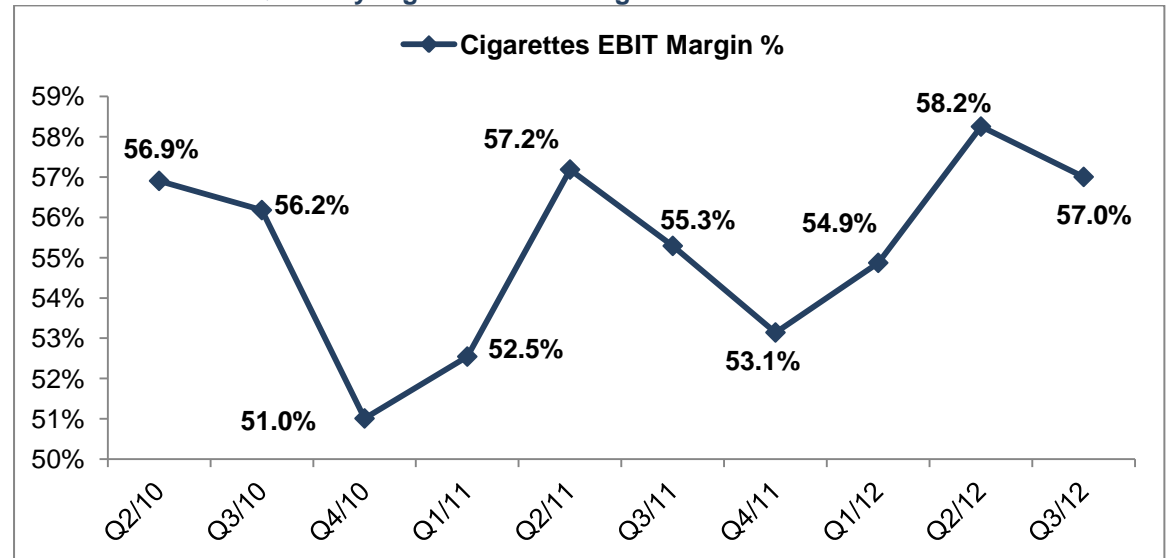
Exhibit 3: EBIT Margin

EBIT Margin	Q3 FY12	Q3 FY11	YoY bps	Q2 FY12	QoQ bps
Agri Business	12.4%	13.2%	(79) bps	16.6%	(421) bps
Cigarettes	57.0%	55.3%	176 bps	58.2%	(120) bps
FMCG (non-cigarette)	-3.4%	-6.7%	328 bps	-4.2%	77 bps
Hotels	36.5%	31.5%	504 bps	20.6%	1593 bps
Paper, Paper Boards & packaging	22.9%	21.8%	111 bps	28.8%	(589) bps

Source: Ace Equity, SIHL Research

EBIT Margin (%)

Source: Ace Equity, SIHL Research

Exhibit 4: Trend in Quarterly Cigarette EBIT Margin

Source: Ace Equity, SIHL Research

Exhibit 5: Standalone Quarterly Income Statement

Particulars, (Rs. Cr.)	Q3 FY12	Q3 FY11	YoY	Q2 FY12	QoQ
Net Sales	6,195	5,424	14.2%	5,974	3.7%
Other Operating Income	52	49	7.9%	111	-52.8%
Total Income	6,248	5,473	14.2%	6,085	2.7%
Total Expenditure	3,867	3,455	11.9%	3,866	0.0%
EBITDA	2,381	2,018	18.0%	2,219	7.3%
EBITDA Margin%	38.1%	36.9%	124 bps	36.5%	165 bps
Depreciation	174	168	3.4%	170	2.2%
EBIT	2,207	1,850	19.3%	2,049	7.7%
EBIT Margin%	35.3%	33.8%	153 bps	33.7%	166 bps
Other Income	285	193	48.1%	181	57.7%
Interest	16	11	41.4%	14	10.5%
PBT	2,477	2,031	21.9%	2,215	11.8%
PBT Margin%	39.6%	37.1%	252 bps	36.4%	323 bps
Tax	776	642	20.8%	701	10.6%
Effective Tax Rate	31.3%	31.6%	(30) bps	31.6%	(33) bps
PAT	1,701	1,389	22.5%	1,514	12.3%
PAT Margin%	27.2%	25.4%	184 bps	24.9%	234 bps
Adj. EPS	2.18	1.78	22.5%	1.94	12.3%

Source: Ace Equity, SIHL Research

Valuation:

Valuation Parameters	Target Price	Weights	Per Share Value
At PE, 28x based on FY13E EPS of Rs.9.10	253	50%	126
EV/EBITDA, of 19.3x based on FY13E EBITDA of Rs.10,404 Cr.	260	50%	130
		Target Price	257
		CMP	205
		Expected Return	25.4%

Source: SIHL Research

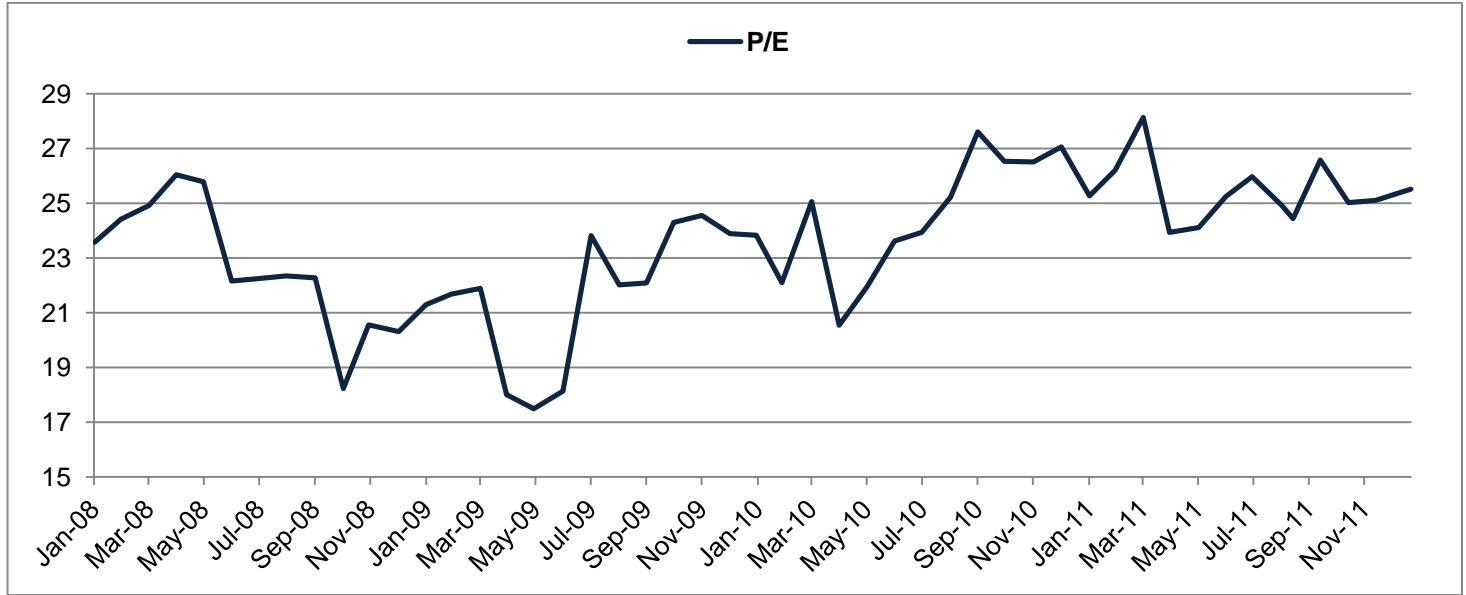
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We have valued the stock on weighted average of stock price arrived based on two different valuation parameters. On EV/EBITDA we arrived at a value of Rs.255/share @ 50% weight. On a PE basis we arrived at a value of Rs.260/share @ 50% weight; based on the weighted average, target price for ITC stock comes at Rs.254/share.

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PE Band

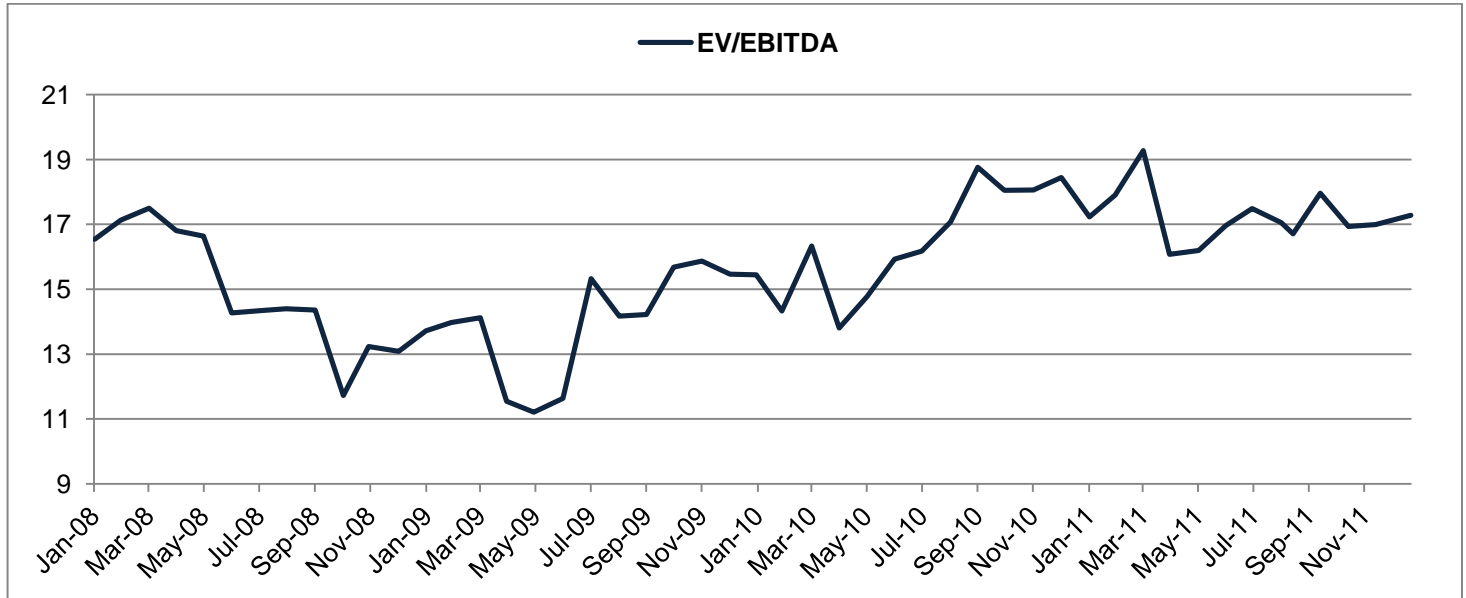


Source: Ace Equity, SIHL Research

PE Valuation

At current market price, the stock is currently traded at PE of 25.7x FY12E EPS of Rs.7.96 and 22.7x FY13E EPS of Rs.9.03. We value the company at 28x its FY13E EPS of Rs.9.03 and arrive at a fair price of Rs.253

EV/EBITDA Band



Source: Ace Equity, SIHL Research

EV/EBITDA Valuation

At current market price, the stock is currently traded at EV/EBITDA of 17.3x FY12E EBITDA of Rs.9,157 Cr. and 15.2x FY13E EBITDA of Rs.10,404 Cr. We value the company at 19.3x its FY13E EBITDA of Rs.10,404 Cr. and arrive at fair price of Rs.260.

Exhibit 6: Standalone Annual Income Statement

Particulars, (Rs. Cr.)	FY09	FY10	FY11	FY12E	FY13E
Gross Revenue	23,144	26,260	30,604	36,756	42,352
Less: Excise Duty	7,532	8,106	9,437	11,321	13,044
Total Income	15,612	18,153	21,168	25,435	29,307
Total Expenditure	10,734	12,062	13,994	16,278	18,903
EBITDA	4,878	6,091	7,173	9,157	10,404
<i>EBITDA Margin %</i>	<i>31.2%</i>	<i>33.6%</i>	<i>33.9%</i>	<i>36.0%</i>	<i>35.5%</i>
Depreciation	550	609	656	728	804
EBIT	4,328	5,483	6,517	8,429	9,600
<i>EBIT Margin %</i>	<i>27.7%</i>	<i>30.2%</i>	<i>30.8%</i>	<i>33.1%</i>	<i>32.8%</i>
Other Income	545	623	829	666	706
Interest	48	90	78	75	75
PBT	4,825	6,015	7,268	9,020	10,231
<i>PBT Margin %</i>	<i>30.9%</i>	<i>33.1%</i>	<i>34.3%</i>	<i>35.5%</i>	<i>34.9%</i>
Tax	1,562	1,954	2,281	2,814	3,192
<i>Effective Tax Rate %</i>	<i>32.4%</i>	<i>32.5%</i>	<i>31.4%</i>	<i>31.2%</i>	<i>31.2%</i>
PAT	3,263	4,061	4,988	6,206	7,039
<i>PAT Margin %</i>	<i>20.9%</i>	<i>22.4%</i>	<i>23.6%</i>	<i>24.4%</i>	<i>24.0%</i>
Adj. EPS (Rs.)	4.22	5.25	6.45	8.02	9.10

Source: Ace Equity, SIHL Research

Exhibit 7: Key Ratios

Particulars	FY09	FY10	FY11	FY12E	FY13E
BV (Rs.)	17.6	18.0	20.5	24.1	28.5
Adj. EPS (Rs.)	4.19	5.21	6.40	7.96	9.03
P/BV, x	11.6	11.3	10.0	8.5	7.2
P/E, x	48.9	39.3	32.0	25.7	22.7
ROE	23.8%	28.9%	31.3%	33.0%	31.7%
ROCE	31.1%	38.7%	40.6%	44.5%	43.1%
EBITDA Margins	31.2%	33.6%	33.9%	36.0%	35.5%
D/E, x	0.01	0.01	0.01	0.01	0.00
EV/EBITDA, x	14.1	16.3	19.3	17.3	15.2

Source: Company Data, SIHL Research

Technical Corner



We have observed ITC has formed a Bullish Price Channel Pattern since 2010 on weekly chart. We strongly believe as long as prices advance and trade within this channel, the trend in ITC will remain bullish. Currently ITC is trading in the lower part of the channel taking support of the lower trend line. Investor can buy ITC at CMP of Rs.205 with a stop loss of Rs.185 for the price target of Rs.240 which is the upper end of the price channel. Stock will gain momentum once it starts trading above the median price line which is 220 plus level.

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